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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation	CC Docket No. 92-135 [FCC 92-258]

INITIAL COMMENTS OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

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NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

Pursuant to Sections 1.49, 1.415, and 1.419 of the Federal Communications Commission's ("FCC" or "Commission") Rules of Practice and Procedure, 47 C.F.R. Sections 1.49, 1.415, and 1.419 (1991), the National Association of Regulatory Utility Commissioners ("NARUC") respectfully submits the following initial comments addressing the Commission's "Notice of Proposed Rulemaking" ("NPRM"), adopted June 18, 1992 and released July 17, 1992, in above-captioned proceeding [FCC 92-258(38416)]:

I. NARUC'S INTEREST

NARUC is a quasi-governmental nonprofit organization founded in 1889. Members include the governmental bodies engaged in the regulation of carriers and utilities from all fifty States, the District of Columbia, Puerto Rico, and the Virgin Islands. NARUC's mission is to improve the quality and effectiveness of public utility regulation in America. Specifically, NARUC is composed of, inter alia, State and territorial officials charged with regulating the telecommunications common carriers within their respective borders. These officials have the obligation to assure that telecommunications services and facilities required by the public convenience and necessity are established, and that service is furnished at just and reasonable rates.

The NPRM raise issues concerning, inter alia, the rate structure for interstate access to local exchange companies ("LECs") networks. Accordingly, the outcome of this proceeding could impact heavily upon these officials' obligations to serve the public interest.

II. BACKGROUND

In the July 17, 1992 NPRM instituting this proceeding, the Commission proposed reforms to provide efficiency incentives for small and mid-sized LECs that remain subject to rate of return regulation of their interstate services. The proposed rules are intended to complement the voluntary price cap system by giving smaller carriers additional options to "correct the efficiency disincentives that traditional, cost-plus regulation introduces."

The 1300 plus LECs that did not opt into price caps represent 6% of the industry and range in size from fewer than 100 to over 1 million access lines. According to the NPRM, they have resisted price caps for a variety of reasons including: unwillingness to assume attendant risks; inability to spread those risks; and discomfort with how price cap regulation is administered. These perceived difficulties have not been outweighed by the promises of higher earnings.

This NPRM proposes three options that, together with price caps presents "..a continuum of incentive-directed regulation." Supposedly, as carriers proceed along the continuum, the risks, potential rewards, and administrative requirements change.

Under the First option, which is open to "midsize" LECs, carriers would file tariffs every two years with cost support derived from historical costs. This option would establish an earnings band targeted at 100 basis points above and 100 basic posits below the FCC authorized rate of return. Carriers could price flexibly within that range pursuant to rules similar to those used in price caps.

Under the Second option, which is open to LECs serving up to 50,000 access lines with gross revenues of up to $40 million, carriers could file tariffs for <u>all</u> interstate service rates based on historical costs for 2-year periods. Under existing rules, the carriers may file such tariffs for traffic sensitive rates only. With the exception of subscriber line charges, no cost support filings would be required - such data would be available on request.

Finally, under the Third option, which is open to the National Exchange Carrier Association ("NECA") and NECA Subset 3 carriers, establishes an improved basic rate of return regulation differing from existing regulation in that (i) carrier access tariffs would be filed every two years instead of annually, and (ii) use of projected costs would be limited and reliance would be directed to historical costs and simple extrapolations from such costs.

The notice seeks comments on these proposals and also solicits suggestions on ways to (i) give pricing flexibility to carriers that choose the third option, and (ii) introduce optional incentive-type plans within NECA pools.

III. COMMENTS

Under the first option, the NPRM envisions the incorporation of a pricing flexibility element for three "baskets:" common line; switched traffic sensitive and special access. Adoption of this option by a LEC would extend the review period to once every two years, using historical data in place of forecasted data. Prices would be frozen unless profitability varies from a narrow range around a target return on equity. No mention is made of including an inflation-adjusted productivity factor, as is the case of the price cap proposals currently used by the FCC in its review of rates charged by large LECs.

Technological improvements, reductions in capital costs, corporate reorganizations, and other developments in recent years have substantially reduced annual operating expenses for telephone companies and are likely to continue to do so. NARUC is troubled by the fact that the FCC's proposed incentive regulation plans assume that expected technological improvements will reduce LEC operating costs at precisely the rate of general inflation. Moreover, under all three options, freezing rates for a two-year period while LEC costs are declining may be more costly to ratepayers than establishing rates in the annual review process, unless incentives will cause LECs to introduce new services or enhance productivity such that benefits will accrue to ratepayers at a rate exceeding a reasonable annual discount rate.

NARUC agrees that improved productivity and the reduction of administrative costs for LECs are worthy goals, but the public interest will not be served unless consumers benefit from those improvements. Accordingly, the FCC should assure that, and make specific findings based upon record evidence that, (i) the regulatory options for small and mid-sized LECs will actually encourage operating efficiencies and (ii) those efficiencies will be passed on to those companies ratepayers. As part of those findings, the FCC should use this proceeding to fashion and implement new regulatory options that will pass on to ratepayers technical efficiency gains as well as a reasonable portion of the additional productivity gains realized from the adoption of any of the proposed incentive plans.

VI. CONCLUSION

NARUC respectfully requests that the Commission carefully consider and implement the suggestions discussed above.

Respectfully submitted,

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APPENDIX A

NARUC'S JULY 28, 1992 RESOLUTION

CONCERNING INCENTIVES FOR NON-PRICE CAP LECS

Resolution on Incentives for Non-Price Cap LECs

WHEREAS, The Federal Communications Commission (FCC) on July 17, 1992, in Docket 92-135 has issued a notice of proposed rulemaking concerning regulatory reforms to provide efficiency incentives for small and mid-sized local exchange carriers (LECs) ; and

WHEREAS, The proposal includes regulatory options which are intended to complement existing regulatory ratemaking practices; and

WHEREAS, The intent of each option is to reduce regulatory burdens or increase the productivity of LECs while maintaining revenue neutrality; and

WHEREAS, The FCC has tentatively concluded in this docket that existing regulatory filing requirements are excessive; and

WHEREAS, Technological improvements, reductions in capital costs, corporate reorganizations, and other developments in recent years have substantially reduced annual operating expenses for telephone companies and are likely to continue to do so; and

WHEREAS, NARUC is troubled by the fact that the FCC's proposed incentive regulation plans assume that expected technological improvements will reduce LEC operating costs at precisely the rate of general inflation; and

WHEREAS, Freezing rates for a two-year period while LEC costs are declining may be more costly to ratepayers than establishing rates in the annual review process, unless incentives will cause LECs to introduce new services or enhance productivity such that benefits will accrue to ratepayers at a rate exceeding a reasonable annual discount rate; therefore, be it

RESOLVED, By the National Association of Regulatory Utility Commissioners (NARUC), assembled at its 1992 Summer committee meetings in Seattle, Washington, that its counsel present its comments to the FCC in Docket 92-135; and be it further

RESOLVED, That NARUC agrees that improved productivity and the reduction of administrative costs for LECs are worthy goals, but the public interest will not be served unless consumers benefit; and be it further

RESOLVED, That the FCC adopt regulatory options for small and mid-sized LECs only upon finding that they will encourage operating efficiencies; and be it further

RESOLVED, That NARUC recommends that the FCC implement new regulatory options that will pass on to ratepayers technical efficiency gains as well as a reasonable portion of the additional productivity gains realized from the adoption of any of the proposed incentive plans.

Sponsored by the NARUC Committee on Communications; Adopted by NARUC Executive Committee July 29, 1992, NARUC No. 32-1992 (8/10/92) at 13.

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CERTIFICATE OF SERVICE

I, JAMES BRADFORD RAMSAY, certify that a copy of the foregoing was served on all parties on the attached Service List.

James Bradford Ramsay
Deputy Assistant General Counsel

National Association of
Regulatory Utility Commissioners

August 28, 1992

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